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SECONDARY MORTGAGE MARKET

Home Loans in the Atlanta Area

Statement of
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Before the
Subcommittee on Consumer and Regulatory Affairs
Committee on Banking, Housing, and Urban Affairs
United States Senate

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of the work we did on secondary mortgage market home loans in Atlanta at the Subcommittee's request. Our work attempted to address the Subcommittee's concerns about racial discrimination in home mortgage lending.

Our November 1990 report on this work provided information on various aspects of the secondary mortgage market operations of the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), and Government National Mortgage Association (Ginnie Mae). Because Ginnie Mae does not have an automated system for identifying the details of the individual federally insured and guaranteed home mortgage loans that it handles, we used loans insured by the Department of Housing and Urban Development (HUD) to represent Ginnie Mae. As you requested, our testimony today focuses on the number, value, and location of single-family home mortgage loans these agencies purchased or insured in the Atlanta, Georgia, metropolitan area.

In summary, we found that the combined secondary mortgage market purchases made or insured in Atlanta by Fannie Mae, Freddie Mac, and HUD during the 2-year period ended June 30, 1989, generally declined as the neighborhoods' average income decreased and as the neighborhoods' minority composition increased. However, Mr. Chairman, in our opinion, these data cannot be relied on to reach conclusions on racial discrimination. There are a number of limitations in the data that prevented us from determining the reasons for variations in loan activity among Atlanta neighborhoods. One key limitation is that the data do not reflect the demand for loans. Loan demand is a primary factor in determining whether credit needs for housing have been met and a potentially significant reason for differences in loan activity among neighborhoods.

BACKGROUND

As you know, Mr. Chairman, secondary mortgage market agencies buy and sell mortgage loans or securities backed by mortgage loans. By purchasing home loans, the secondary mortgage market agencies spread financial risk and provide liquidity to primary lenders, thereby making additional credit available to qualified borrowers.

These agencies are not primary lenders and have no direct contact with borrowers. They do not originate mortgage loans; rather, they purchase loans from lenders or guarantee securities based on the loans. However, the agencies do provide guidance to lenders on the types of loans they will buy and the documentation required. Many lenders accept these as standards for loans they

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Secondary Mortgage Market: Information on Underwriting and Home Loans in the Atlanta Area (GAO/RCED-91-2, Nov. 28, 1990).

originate. These standards are based on certain risk assessments. The risk assessments include the (1) borrower's ability to repay the debt, (2) borrower's willingness to repay the debt, and (3) sufficiency of the property to secure the mortgage.

Fannie Mae, Freddie Mac, and Ginnie Mae were created by the Congress for the purpose of sponsoring a secondary market for mortgages. Although under federal charter, Fannie Mae and Freddie Mac are private corporations. However, Ginnie Mae is a United States government corporation. From 1987 through the first half of 1989, Fannie Mae, Freddie Mac, and Ginnie Mae accounted for 57 percent of the total dollar volume of loan purchases in the secondary mortgage market. Fannie Mae and Freddie Mac together marketed most of these mortgages. Ginnie Mae guarantees securities backed by mortgage loans insured by HUD or guaranteed by the Department of Veterans Affairs.

METHODOLOGY

The statistical data we are presenting for Fannie Mae, Freddie Mac, and HUD represent the number and value of single-family home mortgage loans that these organizations purchased or insured within 80 residential ZIP code areas in a five-county metropolitan Atlanta area (Clayton, Cobb, Dekalb, Fulton, and Gwinnett) between July 1, 1987, through June 30, 1989. Although the agencies identified more than 80 ZIP codes in the five counties, our consolidation of loan activity and demographic data from various sources resulted in 80 ZIP codes for use in our study. Overall, our study of data for the 80 ZIP code areas represents about 85 percent of both the number and the total dollar value of loan activity the agencies reported to us.

An understanding of the demographic make-up of the metropolitan Atlanta area is important to the assessment of secondary market loan activity over race and income variables. Four of the five metropolitan Atlanta counties, Clayton, Cobb, Dekalb, and Gwinnett, are predominately white (86, 92, 68, and 97 percent, respectively). Fulton County, which contains most of the city of Atlanta, is 51 percent minority.

To identify the racial composition of the ZIP code areas, we defined two racial groups--white and minority. We classified the demographic data in terms of the percentage of white individuals by ZIP code area and sorted the data into five categories groups ranging from 0 to 20 percent white to 81 to 100 percent white. We defined areas with 40 percent or less white as being predominately

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The source of these data, HUD, includes Ginnie Mae's issuance of securities in the loan purchase data. However, technically, Ginnie Mae does not purchase mortgages.

minority and those with 61 percent or more white as predominately white.

To show the loan activity within ZIP code areas having various income levels, we sorted the mortgage loan activity data by four income levels across the 80 ZIP code areas ($7,500 to $24,999; $25,000 to $34,999; $35,000 to $49,999; and $50,000 to $74,999). In order to provide greater comparability in terms of the population of homeowners we arrayed our data to reflect the number of loans per 100 homeowners in an income or racial category.

DATA LIMITATIONS

The loan activity data provides information on the extent and location of secondary mortgage market loan activity in the metropolitan Atlanta area. However, data limitations prevented us from determining the reasons for variations in loan activity among ZIP code areas. Thus, these data should not be used to derive conclusions on discrimination in home mortgage lending. For example, a key limitation in the data is that it does not reflect the demand for loans--a primary factor in determining whether credit needs for housing have been met and a potentially significant reason for differences in loan activity among ZIP code areas. Appendix I describes some of the other limitations contained in the loan activity data.

However, better information on mortgage lending will be available later this year. As you know Mr. Chairman, since January 1, 1990, under the Financial Institution Reform, Recovery, and Enforcement Act of 1989 (P.L. 101-73, Aug. 9, 1989), most lenders have had to retain information on loan applications, loans actually made, loans purchased, and other borrower-specific data. The first year of this data-gathering is now complete, and later this year the Federal Reserve Board should be releasing reports based on this data. Also, the 1990 Census should provide more up-to-date demographic data.

LOAN ACTIVITY IN ATLANTA

During the 2-year period from July 1, 1987, through June 30, 1989, Fannie Mae, Freddie Mac, and HUD purchased or insured 57,227 home loans in the metropolitan Atlanta area that we studied. About 87 percent of these loans were for properties in predominately white (61 percent or more white) ZIP code areas. About 83 percent of these loans were for properties in ZIP code areas having average annual incomes of $35,000 to $74,999. Median home prices were also highest in the predominately white, higher income areas.

Fannie Mae, Freddie Mac, and HUD purchased or insured almost twice as many home mortgage loans per 100 homeowners in predominately white (61 percent or more white) areas as in predominately minority (40 percent or less white) areas. In areas

with a predominately white population, Fannie Mae, Freddie Mac, and HUD purchased or insured 13.9 loans per 100 homeowners. In areas with a predominately minority population, the agencies' loan activity was 7.0 loans per 100 homeowners.

Fannie Mae, Freddie Mac, and HUD purchased or insured the greatest number of loans per 100 homeowners in ZIP code areas with higher income levels. For example, loan activity per 100 homeowners was 1.8 times as great in areas with average income levels of $35,000 to $74,999 as it was in areas with average income levels of $7,500 to $34,999. Loan activity per 100 homeowners generally fluctuated for the five racial groups when average income was similar. However, for ZIP code areas having an average income of $25,000 to $34,999, the number of loans per 100 homeowners increased as the percent of white population increased. Loan activity varied with no specific pattern for the population groups having average incomes in the remaining three income levels.

Home prices were generally higher in white and higher income areas. For example, in the 20 percent or less white areas, the median home price was about $56,000, and in the 81 percent or more white areas, the median home price was $101,000. The median home price ranged from $53,000 in the lower income ($7,500 to $24,999) areas to $146,000 in the higher income ($50,000 to $74,999) areas.

The average and median loan amounts purchased or insured by these three agencies increased as the percentage of white population increased. For example, the average loan amount increased about 76 percent (from $46,168 to $81,179) from the 20 percent or less white to the 81 percent or more white racial groups. The median loan amount increased 103 percent (from $38,763 to $78,762) over the same range. The average and median loan amounts also increased as the average income of the ZIP code areas increased.

AGENCIES RESPONSES TO OUR REPORT

In their comments to us, Fannie Mae and HUD reiterated the importance of not misinterpreting the loan activity data. Fannie Mae also pointed out that our report warrants concern from all sectors of the mortgage finance industry. Freddie Mac pointed out that it had leadership responsibilities in support of affordable housing opportunities and against discriminatory lending practices. Freddie Mac and Fannie Mae also stressed their commitment to ensure that all potential homebuyers have equal access to credit. They pointed to ongoing or recently created programs or activities to address this issue.

HUD said that because it has a much lower maximum loan amount than Freddie Mac or Fannie Mae, it believes a very different geographic pattern may emerge for its loan activity data than the pattern resulting from combining its data with those two agencies.

We combined the loan activity data of Freddie Mac, Fannie Mae, and HUD because Freddie Mac and Fannie Mae stated that the data they provided to us was confidential. We understand that, in the opinion of these agencies, release of this data could disclose to their competitors the extent of market penetration and strategies employed by them in Atlanta neighborhoods.

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In closing Mr. Chairman, while the loan activity data we reported do not demonstrate whether or not racial discrimination has occurred, they do provide information on the extent and location of secondary mortgage market loan activity in the Atlanta area during a certain point in time. We hope that more exact insights into such issues will be possible once better information is available.

Mr. Chairman, this concludes my statement. I welcome the opportunity to respond to any questions that you or Members of the Subcommittee may have.

Illustrations of Data Limitations

Data limitations other than loan demand included the use of multiple sources of data that we could not verify for accuracy, the absence of comparable housing markets within ZIP code areas, and the lack of information on the race of the actual buyer. Thus, we could examine lending patterns by race only by looking at loan activity for specific areas and determining the racial composition of these areas. We sorted the data for Fannie Mae, Freddie Mac, and HUD for two demographic variables--number of individuals by race and average income--for each of the 80 ZIP codes in our review.

However, the demographics of the Atlanta area produced uneven distribution of the 80 ZIP codes over the five racial and four income categories we defined. The number of ZIP code areas in the various population groups/income levels varied from 0 to 37. In some instances, as few as one or two ZIP codes fell into a particular category. This uneven distribution of the ZIP codes over the various categories may, in part, explain the loan activity patterns. For example, an income and/or racial composition category may reflect unique characteristics, such as proximity to commercial activity, which may prevent lenders from originating loans in those areas. What this means to us, then, is that we cannot determine whether the loan activity patterns are representative of the agencies' purchasing or insuring tendencies or some other factors.

Also, not all of the racial groups contained each of the income levels. For example, only one income level, $25,000 to $34,999, is common to each of the five racial groups. For this income category, the number of loans per 100 homeowners increased as the percent of white population increased. Homeowners in the 81 to 100 percent white ZIP code areas received 41 percent (or 2.8) more loans per 100 homeowners than in the 0 to 20 percent white ZIP code areas at this income level. In addition, seven income levels show no activity. This does not necessarily mean that secondary market agencies are not buying any loans in the predominately minority, middle- and upper-income areas of Atlanta; it means only that our study did not contain any ZIP code areas that fell within these race/income categories.